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Callahan Financial Newsletter

Keeping you current

Financial Mistakes People Make at Different Ages

There's a saying that with age comes wisdom, but this may not always be true in the financial world. As people move through different life stages, there are new opportunities--and potential pitfalls--around every corner.

In your 20s

Living beyond your means. It's tempting to want all the latest and greatest in gadgets, entertainment, and travel, but if you can't pay for most of your wants up front, then you need to rein in your lifestyle. If you take on too much debt--or don't work diligently to start paying off the debt you have--it can hold you back financially for a long, long time.

Not saving for retirement. You've got plenty of time, so what's the rush? Well why not harness that time to work for you. Start saving a portion of your annual pay now and your 67-year-old self will thank you.

Not being financially literate. Many students graduate from high school or college without knowing the basics of money management. Learn as much as you can about saving, budgeting, and investing now so you can benefit from it for the rest of your life.

In your 30s

Being house poor. Whether you're buying your first home or trading up, don't buy a house that *you* can't afford, even if the *bank* says you can. Build in some wiggle room for a possible dip in household income that could result from switching jobs, going back to school, or leaving the workforce to raise a family.

Not protecting yourself with life and disability insurance. Life is unpredictable. What would happen if one day you were unable to work and earn a paycheck? Let go of the "it-won't-happen-to-me" attitude. Though the cost and availability of life insurance depend on several factors including your health, the younger you are when you buy insurance, the lower your premiums will likely be.

Not saving for retirement. Okay, maybe your 20s passed you by in a bit of a blur and retirement wasn't even on your radar screen. But now that you're in your 30s, it's critical to start saving for retirement. Wait much longer, and it can be hard to catch up. Start now, and you still have 30 years or more to save.

In your 40s

Trying to keep up with the Joneses. Appearances can be deceptive. The nice homes, cars, vacations, and "stuff" that others have might make you wonder whether you should be buying these things, too. But behind the scenes, your neighbors could be taking on a lot of debt. Take pride in your savings account instead.

Funding college over retirement. In your 40s, saving for your children's college costs over your own retirement is a mistake. If you have limited funds, set aside a portion for college but earmark the majority for retirement. Then sit down with your teenager and have a frank discussion about academic options that won't break the bank--for either of you.

Not having a will or an advance medical directive. No one likes to think about death or catastrophic injury, but these documents can help your loved ones immensely if something unexpected should happen to you.

In your 50s and 60s

Co-signing loans for adult children. Co-signing means you're on the hook--completely--if your child can't pay, a situation you don't want to find yourself in as you're getting ready to retire.

Raiding your home equity or retirement funds. It goes without saying that doing so will prolong your debt and/or reduce your nest egg.

Not quantifying your retirement income. As you approach retirement, you should know how much you can expect from Social Security (at age 62, at your full retirement age, and at age 70), pension income, and your personal retirement savings.

Not understanding health-care costs in retirement. Before you turn age 65, review what Medicare does and doesn't cover, and how gap insurance policies fit into the picture.

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Millennials vs. Boomers: How Wide Is the Gap?

Can you tell the difference between the attitudes of baby boomers and millennials when it comes to finances? Take this quiz and see.

Texting versus email (or even snail mail). Angry Birds versus Monopoly. "The Theory of Everything" versus "The Sound of Music." "Dancing with the Stars" versus "American Bandstand."

It's no secret that there are a lot of differences between baby boomers, born between 1946-1964, and millennials, who were generally born after 1980 (though there is disagreement over the precise time frame for millennials). But when it comes to finances, there may not be as much difference in some areas as you might expect. See if you can guess which generation is more likely to have made the following statements.

Boomer or millennial?

1) I have enough money to lead the life I want, or believe I will in the future.

2) My high school degree has increased my potential earning power.

3) I rely on my checking account to pay for my day-to-day purchases.

4) I consider myself a conservative investor.

5) Generally speaking, most people can be trusted.

6) I'm worried that I won't be able to pay off the debts that I owe.

The answers

1) Millennials. According to a 2014 survey by the Pew Research Center, millennials were more optimistic about their finances than any other generational cohort, including baby boomers. Roughly 85% of millennials said they either currently had enough to meet their financial needs or expected to be able to live the lives they want in the future; that's substantially higher than the 60% of boomers who said the same thing. Although a higher percentage of boomers--45%--said they currently have enough to meet their needs, only 32% of millennials felt they had enough money right now, though another 53% were hopeful about their financial futures. Source: "Millennials in Adulthood," Pew Research Center, 2014

2) Boomers. The ability of a high school education to provide an income has dropped since the boomers' last senior prom, while a college education has never been more valuable. In 1979, the typical high school graduate's earnings were 77% of a college graduate's; in 2013, millennials with a high school diploma earned only 62% of what a college graduate did. And 22% of millennials with only a high school degree were living in poverty in 2013; back in 1979, the figure for boomers at that age was 7%. Source: "The Rising Cost of Not Going to College," Pew Research Center, 2014

3) Boomers. Not surprisingly, millennials are far more likely than boomers to use alternative payment methods for day-to-day expenses. A study by the FINRA Investor Education Foundation found that millennials are almost twice as likely as boomers to use prepaid debit cards (31% compared to 16% of boomers). They're also more than six times as likely to use mobile payment methods such as Apple Pay or Google Wallet; 13% of millennials reported using mobile methods, while only 2% of boomers had done so. Source: "The Financial Capability of Young Adults--A Generational View," *FINRA Foundation Financial Capability Insights,* FINRA Investor Education Foundation, 2014

4) Millennials. You might think that with thousands of baby boomers retiring every day, the boomers might be the cautious ones. But in one survey of U.S. investors, only 31% of boomers identified themselves as conservative investors. By contrast, 43% of millennials described themselves as conservative when it came to investing. The survey also found that millennials outscored boomers on whether they wanted to leave money to their children (40% vs. 25%) and in wanting to improve their understanding of investing (44% vs. 38%). Source: Accenture, "Generation D: An Emerging and Important Investor Segment," 2013

5) Boomers. Millennials may have been around the track fewer times than boomers have, but their experiences seem to have given them a more jaundiced view of human nature. In the Pew Research "Millennials in Adulthood" survey, only 19% of millennials said most people can be trusted; with boomers, that percentage was 31%. However, millennials were slightly more upbeat about the future of the country; 49% of millennials said the country's best years lie ahead, while only 44% of boomers agreed.

6) Millennials. However, the difference between the generations might not be as significant as you might think. In the FINRA Foundation financial capability study, 55% of millennials with student loans said they were concerned about being able to pay off their debt. That's not much higher than the 50% of boomers who were worried about debt repayment.

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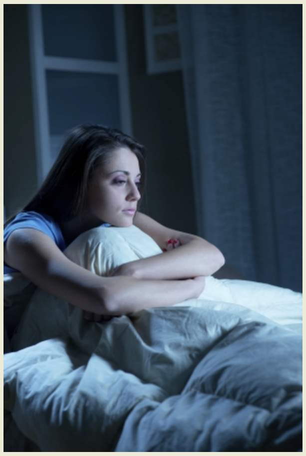
Five Steps to Tame Financial Stress



Seventy-two percent of adults report feeling stressed about money at least some of the time, and 22% say that the amount of stress they experience is extreme.

Source: American Psychological Association

Do you sometimes lie awake at night thinking about bills that need to be paid? Does it feel as though you're drowning in debt? If this describes you, you might take solace in the fact that you're not alone. A recent report released by the American Psychological Association (APA) showed that 72% of adults feel stressed about money at least some of the time, and 22% said the amount of stress they experienced was extreme.[1]

The bad news is that stress can be responsible for multiple health problems, including fatigue, headaches, and depression. And, over time, stress can contribute to more significant health issues, including high blood pressure and heart disease.[2] The good news is that there are some simple steps you can take to reduce or eliminate some of the financial stress in your life.

1. Stop and assess

The first step in reducing financial stress is to look at your situation objectively, creating a snapshot of your current financial condition. Sit down and list all of your financial obligations. Start with the items that are causing you the most stress. For debts, include the principal due, the applicable interest rate, and the minimum payment amount. If you're not already doing so, review your bank account and credit-card statements to track where your money is going. The goal here is not to solve the problem; it's to determine and document the scope of the problem. You might find that this step alone significantly helps alleviate your stress level (think of it as facing your fears).

2. Talk to your spouse

If you're married, talk to your spouse. It's important to communicate with your spouse for several reasons. First, you and your spouse need to be on the same financial page; any steps you take to improve your situation are going to be most effective if pursued jointly. Second, not being on the same page as your spouse is only going to lead to additional stress. In fact, the APA report showed that 31% of spouses and partners say that money is a major source of conflict or tension in their relationship.[3] Additionally, your spouse or partner can be a valuable source of emotional support, and this emotional support alone can lower stress levels.[4] If you're not married, family or friends might fill this role.

3. Take control

First, go back and take a look at where your money is going. Are there changes you can make that will free up funds you can save or apply elsewhere? Even small changes can make a difference. And exerting control over your situation to any degree can help reduce your overall stress level. Start building a cash reserve, or emergency fund, by saving a little bit each paycheck. Think of the emergency fund as a safety net; just knowing it's there will help reduce your ongoing level of stress. Work up to a full spending plan (yes, that's another way of saying a budget) where you prioritize your expenses, set spending goals, and then stick to them going forward.

4. Think longer term

Look for ways to reduce debt long term. You might pay more toward balances that have the highest interest rates. Or you might consider refinancing or consolidation options as well. Beyond that, though, you really want to start thinking about your long-term financial goals, identifying and prioritizing your goals, calculating how much you might need to fund those goals, and implementing a plan that accounts for those goals. Having a plan in place can help you with your stress levels, both now and in the future.

5. Get help

Always remember that you don't need to handle this alone. If the emotional support of a spouse, friends, or family isn't enough, or the level of stress that you're feeling is just too much, know that there is help available. Consider talking to your primary-care physician, a mental health professional, or an employee assistance resource, for example.

A financial professional can also be a valuable resource in helping you work through some of the steps discussed here, and can help direct you to other sources of assistance, like credit or debt counseling services, depending on your needs.

The most important thing to keep in mind is that you have the ability to control the amount of financial stress in your life.

[1,3,4] American Psychological Association, "Stress in America™: Paying with Our Health," www.stressinamerica.org, February 4, 2015

[2] Mayo Clinic Staff, "Stress Symptoms: Effects on Your Body and Behavior," www.mayoclinic.org, July 19, 2013

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What return are you really earning on your money?

If you're like most people, you probably want to know what return you might expect before you invest. But to translate a given rate of return into actual income or growth potential, you'll need to understand the difference between *nominal return* and *real return,* and how that difference can affect your ability to target financial goals.

Let's say you have a certificate of deposit (CD) that's about to expire. The yield on the new three-year CD you're considering is 1.5%.

But that 1.5% is the CD's nominal rate of return; it doesn't account for inflation or taxes. If you're taxed at the 28% federal income tax rate, roughly 0.42% of that 1.5% will be gobbled up by federal taxes on the interest. Okay, you say, that still leaves an interest rate of 1.08%; at least you're earning something.

However, you also need to consider the purchasing power of the interest that the CD pays. Even though inflation is relatively low today, it can still affect your purchasing power, especially over time. Let's say that consumer prices have gone up by 1% over the past year and you adjust your 1.08% after-tax return for inflation. Suddenly, you're barely breaking even on your investment.

What's left after the impact of inflation and taxes is your real return, because that's what you're really earning in actual purchasing power. If the nominal return on an investment is low enough, the real return can actually be negative, depending on your tax bracket and the inflation rate over time. Though this hypothetical example doesn't represent the performance of any actual investment, it illustrates the importance of understanding what you're really earning.

Knowing the difference between nominal and real return may help you make better decisions when it comes to investing your money. You'll want to choose investments that match your financial goals and tolerance for risk. In some cases, the security an investment offers may be important enough that you're willing to accept a low real return; in other cases, you may choose an investment that has the potential for a higher real return but carries a higher degree of risk.

What is asset allocation?

Each type of investment has specific strengths and weaknesses that enable it to play a specific role in your overall investing strategy. Some investments may offer growth potential. Others may provide regular income or relative safety, or simply serve as a temporary place to park your money. And some investments may even serve to fill more than one role. Because you likely have multiple needs and objectives, you probably need some combination of investment types, or asset classes.

Balancing how much of each asset class should be included in your portfolio is a critical task. The balance between growth, income, and safety is determined by your asset allocation, and it can help you manage the level and types of risks you face.

The combination of investments you choose can be as important as your specific investments. Your mix of various asset classes such as stocks, bonds, and cash alternatives generally accounts for most of the ups and downs of your portfolio's returns.

Ideally, your portfolio should have an overall combination of investments that minimizes the risk you take in trying to achieve a targeted rate of return. This often means balancing conservative investments against others that are designed to provide a higher potential return but also involve more risk. However, asset allocation doesn't guarantee a profit or eliminate the possibility of investment loss.

Someone living on a fixed income, whose priority is having a regular stream of money coming in, will probably need a very different asset allocation than a young, well-to-do working professional whose priority is saving for a retirement that's 30 years away. Even if two people are the same age and have similar incomes, they may have very different needs and goals, and their asset allocations should be tailored to their unique circumstances.

And remember, even if your asset allocation was appropriate for you when you chose it, it may not be appropriate for you now. It should change as your circumstances do and as new ways to invest are introduced. A piece of clothing you wore 10 years ago may not fit now; you just might need to update your asset allocation, too.